

Letter of Findings Number: 04-20110119
Use Tax
For Tax Year 2008

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ISSUE

I. Use Tax—Production Materials.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-5-1; IC § 6-8.1-5-1; [45 IAC 2.2-3-4](#); [45 IAC 2.2-5-10](#).

Taxpayer protests the imposition of use tax on purchases of materials it claims are used in the production of tangible personal property.

STATEMENT OF FACTS

Taxpayer is an Indiana corporation. As the result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer had not paid sales tax at the time it purchased certain items which were subject to sales or use tax in the tax year 2008. The Department therefore issued proposed assessments for use tax and interest for 2008. Taxpayer protests that some of the items listed as taxable were consumed in the production process and were therefore exempt from sales and use taxes. A hearing was held and this Letter of Findings results. Further facts will be supplied as required.

I. Use Tax—Production Materials.

DISCUSSION

Taxpayer protests that some of the items which the Department listed as taxable in its audit report were actually exempt from sales and use taxes. Taxpayer states that the items in question were used in its powder-coating services and were thus incorporated into the powder coatings supplied to its customers. The Department notes that the burden of proving a proposed assessment wrong rests with the person against whom the proposed assessments are made, as provided by IC § 6-8.1-5-1(c).

The sales tax is imposed by IC § 6-2.5-2-1, which states:

(a) An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana.

(b) The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state.

The use tax is imposed under IC § 6-2.5-3-2(a), which states:

(a) An excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction.

Also, [45 IAC 2.2-3-4](#) provides:

Tangible personal property, purchased in Indiana, or elsewhere in a retail transaction, and stored, used, or otherwise consumed in Indiana is subject to Indiana use tax for such property, unless the Indiana state gross retail tax has been collected at the point of purchase.

Therefore, when tangible personal property is acquired in a retail transaction and is stored, used, or consumed in Indiana, Indiana use tax is due if sales tax has not been paid at the point of purchase. The Department determined that Taxpayer had not paid sales tax on some taxable purchases and so imposed Indiana use tax on those purchases.

Of relevance is IC § 6-2.5-5-1, which provides in relevant part:

(a) As used in this section, "tangible personal property" includes electrical energy, natural or artificial gas, water, steam, and steam heat.

(b) Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for direct consumption as a material to be consumed in the direct production of other tangible personal property in the person's business of manufacturing, processing, refining, repairing, mining, agriculture, horticulture, floriculture, or arboriculture. This exemption includes transactions involving acquisitions of tangible personal property used in commercial printing.

....

(Emphasis added).

Also of relevance is [45 IAC 2.2-5-10\(a\)](#), which states:

In general, all purchases of tangible personal property by persons engaged in the processing or refining of tangible personal property are taxable. The exemption provided in this regulation [[45 IAC 2.2](#)] extends only to manufacturing machinery, tools, and equipment used in direct production. It does not apply to materials consumed in production or to materials incorporated into the tangible personal property produced.

Additionally, the exemption provided in this regulation [[45 IAC 2.2](#)] extends to industrial processors. An industrial processor, as defined in [IC 6-2.5-4-2](#), is one who:

- (1) acquires tangible personal property owned by another person;
 - (2) provides industrial processing or servicing, including enameling or plating, on the property; and
 - (3) transfers the property back to the owner to be sold by that owner either in the same form or as a part of other tangible personal property produced by that owner in his business of manufacturing, assembling, constructing, refining, or processing.
- (Emphasis added).

Therefore, the materials must be directly consumed in the direct production of other tangible personal property in order to qualify for the exemption provided by IC § 6-2.5-5-1(b).

A review of the items which Taxpayer believes are eligible for the exemption, showed that one of the items is a binding agent or primer which is required to allow the powder coating to adhere to the metal being coated. Specifically, "AE-3003" is directly consumed in the direct production of other tangible personal property and is eligible for the exemption found at IC § 6-2.5-5-1(b). The AE-3003 purchases will be removed from the list of taxable items in the Department's calculations.

However, the other items listed are cleaning agents or parts for cleaning equipment. Taxpayer explained that the metal parts must be cleaned prior to the application of any coating or else the coating would not adhere to the metal. While this is undoubtedly necessary, the cleaning is a pre-production step and does not qualify for the exemption found at IC § 6-2.5-5-1. The cleaning does not directly consume materials in the direct production of other tangible personal property, and so those purchases are properly subject to sales and/or use tax.

In conclusion, Taxpayer has met its burden regarding the purchases of AE-3003. Those materials are directly consumed in the direct production of other tangible personal property, as required by IC § 6-2.5-5-1. The other items are cleaning agents or cleaning machinery parts used in pre-production activities and are not eligible for the exemption. The amounts of purchases for the AE-3003 will be removed from the Department's calculations of use tax due for 2008. Interest will be recalculated to reflect the adjustments to base tax.

FINDING

Taxpayer's protest is sustained in part and denied in part, as described above.

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